

**Letter of Findings Number: 04-20110389**  
**Sales and Use Tax**  
**For Tax Years 2007-2009**

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**ISSUES**

**I. Sales and Use Tax—Manufacturing Exemption.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); General Motors Corp. v. Indiana Dep't. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Mumma Bros. Drilling Co. v. Department of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Department of Revenue v. U. S. Steel Corp., 425 N.E.2d 659 (Ind. Ct. App. 1981); Mynsberge v. Indiana Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Letter of Findings 04-20060498 (June 7, 2007).

Taxpayer protests the assessment of use tax on a variety of purchases used in manufacturing.

**II. Sales and Use Tax—Property Used Outside of Indiana.**

**Authority:** IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1.

Taxpayer protests the assessment of use tax on property that is delivered and used outside of Indiana.

**III. Sales and Use Tax—"Service and Installation Charges."**

**Authority:** IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-1-1](#); [45 IAC 2.2-4-2](#); Allied Collection Service v. Ind. Dep't of State Revenue, 899 N.E.2d 69 (Ind. Tax Ct. 2008).

Taxpayer protests the imposition of use tax on charges for services and installation.

**STATEMENT OF FACTS**

Taxpayer is an Indiana LLC operating a manufacturing plant in Indiana. Taxpayer manufactures custom vehicle components that are purchased by other manufacturers to be incorporated into those manufacturer's vehicles. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and made assessments of use tax and interest for the 2007, 2008, and 2009 tax years. The Department found that Taxpayer had made a variety of purchases on which the Indiana sales tax was not paid at the time of purchase nor was use tax remitted to the Department. Taxpayer disagreed with a number of the audit results and protested. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

**I. Sales and Use Tax—Manufacturing Exemption.**

**DISCUSSION**

Taxpayer asserts that certain of its purchases are not subject to use tax because the purchases would qualify for the manufacturing equipment exemption as found in IC § 6-2.5-5-3.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "Exemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588

(Ind. 1992) (Internal citations omitted). Thus, "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." RCA, 310 N.E.2d at 100-101. Accordingly, the taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. General Motors, 578 N.E.2d at 404.

IC § 6-2.5-5-3(b) provides:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).**

Thus, the legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture... of other tangible personal property." In enacting the exemption, the legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "Fairly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." Mumma Bros. Drilling Co. v. Department of Revenue, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, must (1) be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." Indiana Dep't. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being 'produced.'" Id. Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. General Motors, 578 N.E.2d at 401. The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#). [45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form."

[45 IAC 2.2-5-8\(g\)](#) further states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Additionally, [45 IAC 2.2-5-8 \(j\)](#) provides:

Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading.

Accordingly, tangible personal property purchased for the use in the production of a manufactured good is subject to sales and use tax unless the property has an immediate effect on and is essential to the production of the marketable good. Thus, it is only the property that has an immediate effect on and is essential to the production that is directly used in the direct production of a marketable good and is exempt.

#### **A. "Mold Maintenance Equipment" and "Mold Release System."**

The Department found that use tax was due on Taxpayer's purchase of "mold maintenance equipment" and of "waterborne mold release system equipment." The Department's audit report on page 5 states, as follows:

The line items identified [by Taxpayer] as part of the "waterborne mold release system"... were identified by plant personnel as being the sub tanks used to store the mold release material (prior to production), and the lines to transport the mold release to the production floor, not the actual production equipment which sprays the mold release onto the molds during production. Other line items included [by Taxpayer] in this category

were identified as part of the "ISO bulk storage" and "raw materials feeder" systems which store liquid foam (raw material) and transport the liquid to the production line, and as part of the "carrier conveyor" system which transports raw materials (chemicals) to the production line.

The [Department] has taxed the storage equipment as raw materials storage, and the liquid lines as pre-production transportation of raw materials... in accordance with [45 IAC 2.2-5-8\(d\)](#), (e), and (f). Tools and equipment that are used to move the molds between the production line and the mold maintenance area, and tools that are used within the mold maintenance area have been taxed as maintenance equipment under [45 IAC 2.2-5-8\(h\)](#). No assessment was made on production line equipment used to spray the mold release onto the molds during production.

Taxpayer protests the assessments of use tax on its purchase of "mold maintenance equipment" and of "waterborne mold release system equipment." Taxpayer asserts that the "mold maintenance equipment,"—which included "mold jigs," "step platforms," and "overhead cranes,"—and the "waterborne mold release system" equipment are property directly used in the direct production of manufacturing tangible personal property and are exempt from use tax under the "equipment exemption" as defined in IC § 6-2.5-5-3.

#### **1. "Mold Maintenance Equipment."**

The Department found that the "mold maintenance equipment" is used in the performance of general maintenance during times of pre-production and post production and is excluded from "the equipment exemption" found in IC § 6-2.5-5-3. See [45 IAC 2.2-5-8\(d\)](#) & (h)(1).

Taxpayer states that the "mold maintenance equipment" cleans the molds that are used to make the foam seat cushions. Taxpayer further states, "After a predetermined period of time, the molds are removed from the mold line by overhead cranes and are sent to an adjacent room for further cleaning." Taxpayer maintains that the cleaning of the "molds" is necessary to the production process to ensure the quality of the product. Taxpayer maintains that cleaning does not interrupt the production process because when the dirty "molds" are removed to be cleaned, they are replaced with ones that were previously cleaned. Taxpayer states that the cleaning of the molds occurs between shifts, on breaks, and whenever the foam processing is not running. However, Taxpayer did not provide information about how long production is stopped during the exchanging of the "molds," how frequently the molds are exchanged and cleaned, how long it takes to clean the molds, or the useful life of the molds with and without the cleanings.

[45 IAC 2.2-5-8\(h\)\(1\)](#) excludes maintenance activities by providing that "[m]achinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax." Also, [45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form."

When cleaning activities must be preformed constantly during production, frequently throughout production, and are performed during production runs, the cleaning has been found to be essential and integral to Taxpayer's production process and qualified for the equipment exemption under IC § 6-2.5-5-3(b). However, when cleaning activities are performed infrequently and/or are performed between jobs, between production runs, or at the end of the workday, the activities have been found to represent post-production maintenance activities as found in [45 IAC 2.2-5-8\(d\)](#), (h). While Taxpayer did not provide information about the frequency of the cleanings or the useful life of the molds, Taxpayer had stated that the cleaning of the molds happens between shifts, on breaks, and whenever the foam processing is not running. Therefore, Taxpayer's use of the "mold maintenance equipment" would not qualify for the exemption and represent post-production maintenance activities as found in [45 IAC 2.2-5-8\(d\)](#) & (h).

Therefore, Taxpayer's protest to the imposition of use tax on "mold maintenance equipment" is respectfully denied.

#### **2. "Waterborne Mold Release System."**

The Department has found that "Mold release chemicals" can be "essential" to and play an "integral part" in the manufacturing of the certain products. See Letter of Findings 04-20060498 (June 7, 2007), 20070822 Ind. Reg. 045070530 NRA. Without the "mold release chemicals" certain products could not be removed from the molds in one solid piece. The product would come out in pieces or with flaws making it an unmarketable product. Thus, the use of the "mold release chemicals" can be compared to a baker's use of butter or grease to ensure a cake will come out in one piece. However, while the production equipment that is used to spray the "mold release chemicals" and the "mold release chemicals" themselves would be "directly used or consumed" in the manufacturing of the Taxpayer's products, any equipment used to store the raw materials (i.e., the "mold release chemicals") or transport the raw materials prior to their entry into the manufacturing process are taxable. See [45 IAC 2.2-5-8\(d\)](#) (explaining that there are pre-production and post-production activities as the "[d]irect use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required). See [45 IAC 2.2-5-8\(e\)](#) (Stating that "[t]angible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment

necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another"). See [45 IAC 2.2-5-8](#) (f)(1) (stating that "[t]angible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable").

The Department's assessment of use tax was not on the equipment used to spray the "mold release chemicals" or the "mold release chemicals" themselves, but was on equipment which stores and transports the "mold release chemicals" prior to their entry to the production process. Therefore, the Department's assessment of use tax on this equipment was proper. Accordingly, Taxpayer's protest to the imposition of use tax on the "waterborne mold release system" equipment is respectfully denied.

#### **B. "Glue Gun Holster."**

The Department found that use tax was due on Taxpayer's purchase of "glue gun holsters." Taxpayer asserts that the "glue gun holsters" are production equipment that qualifies for the "equipment exemption" found in IC § 6-2.5-5-3. Taxpayer maintains that the "glue gun holsters" are placed along the production line and are attached to the production line. Taxpayer states that the "glue gun holsters" hold the glue gun in place during the production process allowing the employee to merely pull the trigger to put the glue in the exact place needed at the correct time. Taxpayer cites to [45 IAC 2.2-5-8](#)(c) example (2)(E), which states that "[a] work bench used in conjunction with a work station or which supports production machinery within the production process" is an example of equipment that would qualify for exemption.

The "glue gun holsters" in question in this protest are analogous to the work bench discussed in [45 IAC 2.2-5-8](#)(c) example (2)(E). The "glue gun holsters" supports production equipment. Therefore, the "glue gun holsters" at issue qualify for the manufacturing exemption. Accordingly, Taxpayer's protest to the imposition of use tax on the "glue gun holsters" is sustained.

#### **C. "Hydraulic Oil."**

The Department found that use tax was due on Taxpayer's purchase of "hydraulic oil." Taxpayer asserts that the "hydraulic oil" is consumed within their production equipment. Taxpayer maintains that while an estimated fifty percent of the oil was consumed during the pre-production/post-production "tuning" stage and is taxable, the rest of the oil is consumed within the production process.

The "consumption exemption" is found at IC § 6-2.5-5-5.1(b), which provides an exemption from sales and use tax for property "if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing." Property obtained for "direct consumption as a material to be consumed in direct production" is further defined in [45 IAC 2.2-5-12](#)(c) as "materials [that] are directly used in the production process" and have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-12](#)(c).

However, Taxpayer has not provided any information/documentation beyond its assertion that an estimated fifty percent of the oil is used somewhere in its production process. Therefore, Taxpayer has not provided sufficient information to demonstrate that the "hydraulic oil" is directly used in Taxpayer's production of its goods or that it has "an immediate effect on the article being produced." Accordingly, Taxpayer's protest to the imposition of use tax on "hydraulic oil" is respectfully denied.

#### **D. "Air Monitoring Equipment."**

The Department found that use tax was due on Taxpayer's purchase of "air monitoring equipment." Taxpayer asserts that the "air monitoring equipment" is production equipment that qualifies for exemption under [45 IAC 2.2-5-8](#)(c), which allows for sales and use tax exemptions for safety clothing or equipment. Taxpayer states that the equipment evaluates the plant air for any signs of a chemical spill or leak. Taxpayer maintains the equipment is required because it can detect the toxic chemical in the air long before a human can detect it through smell. Taxpayer states "the chemicals may be a carcinogen in humans that also may cause eye damage, skin burns, rashes, and lung irritation that could lead to pulmonary edema.

[45 IAC 2.2-5-8](#)(c) states:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

--EXAMPLES--

...

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

...

(F) **Safety clothing or equipment which is required to allow a worker to participate in the production process without injury** or to prevent contamination of the product during production. **(Emphasis added).**



In *Department of Revenue v. U. S. Steel Corp.*, 425 N.E.2d 659 (Ind. Ct. App. 1981), the appellate court affirmed the trial court's findings, in favor of the taxpayer, U.S. Steel Corp., that it was entitled to the manufacturing exemption for its purchases of personal protective equipment, including, but not limited to, prescription safety eyeglasses, protective mittens, hardhats, goggles, masks, hoods, jackets and aprons. The U.S. Steel court refined the application of the "double direct standard" illustrated in *Indiana Dep't of State Revenue v. Harrison Steel Casting*, 402 N.E.2d 1276 (Ind. Ct. App., 1980) and focused on "whether the safety equipment is an integral part of manufacturing and operates directly on the product during production."

Acknowledging that the "U.S. Steel's safety equipment was one of the tools used by workers to accomplish the job," The U.S. Steel court concluded that:

Since steel can be made only because shielded workers deal directly with the raw materials of the product, the shields not only protect the worker but are a part of manufacturing which operates directly on the product during production.

U.S. Steel, 425 N.E.2d at 664.

As [45 IAC 2.2-5-8\(g\)](#) explains, however, "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property has an immediate effect upon the article being produced." (Internal quotation marks omitted).

In U.S. Steel, but for the shields, the workers would not have been able to directly handle the materials used in the production process. The "air monitoring equipment" is not directly involved in the production process. Even though its existence provides the assurance of a safer operating environment, nonetheless, the "air monitoring equipment" is not identical to the shields in U.S. Steel discussed above. The "air monitoring equipment" is not directly used by workers in the direct manufacturing process. Accordingly, Taxpayer's protest to the imposition of use tax on the "air monitoring equipment" is respectfully denied.

#### **E. "Seat Pad Cart Carrier."**

The Department found that use tax was due on Taxpayer's purchase of a "seat pad cart carrier." Taxpayer asserts that the "seat pad cart carrier" is exempt because it is transporting work in process. Taxpayer maintains that "the movement of the seat frames by carriers from [Taxpayer] to [Taxpayer's sister company] is part of a 'continuous integrated production process' and should be exempt as determined in *General Motors Corp. v. Indiana Dep't of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991)." Taxpayer states:

Once the metal seat frames are die stamped, and welded, the completed frame[s] are placed onto racks and delivered to [Taxpayer's sister company's] building by robotic *[sic]* power carriers that follow lines of magnetic tape on the floor/ground. [Taxpayer's sister company's] building and [Taxpayer's] building are connected by a walk-way tunnel. The frames are then taken by [Taxpayer's sister company] and assembled to make the seats....

However, *General Motors Corp.* is not relevant to Taxpayer's situation because unlike the plants in *General Motors Corp.* that were owned by the same entity, Taxpayer's plant and the assembly plant are owned by two different entities. See *Mynsberge v. Indiana Dep't of State Revenue*, 716 N.E.2d 629, 631 (Ind. Tax Ct. 1999) (determining that the manufacturing exemption for the utilities services and commodities only applies when the purchaser of the utility services and commodities is also the consumer of those services and commodities).

Even if Taxpayer and the assembly plant entity are affiliates in a unitary business, this would have no bearing in this protest and is beyond the scope of this protest. Taxpayer and its affiliate have chosen to operate as separate entities. There is nothing in IC § 6-2.5-5-3 defining "person" that allows a listed entity to change its separate entity status in order to seek a sales and use tax advantage. Therefore, equipment that is used to transport Taxpayer's product after the completion of its production process to another taxpayer is post-production transportation equipment, which does not qualify for exemption under IC § 6-2.5-5-3. See [45 IAC 2.2-5-8\(d\)](#). Accordingly, Taxpayer's protest to the imposition of use tax on the "seat pad carrier cart" is respectfully denied.

#### **F. "Mold Platforms."**

The Department found that use tax was due on Taxpayer's purchase of "mold platforms." Taxpayer maintains that the "mold platforms" are used to raise employees to allow the employee to remove the product—i.e., the foam pads, from the mold. Taxpayer cites to [45 IAC 2.2-5-8\(g\)](#), which states an example of exempt equipment, as follows:

(4) Equipment which constitutes an essential and integral part of the integrated process is exempt. The fact that such equipment is built in a manner to service various pieces of exempt equipment, as an alternative to building the equipment into each of the pieces of exempt machinery, is not determinative.

The production of flat-rolled metal products requires that an oil mixture, which serves as both a rolling lubricant and a coolant, be continuously sprayed on sheets in the rolling mill. Spent oil is simultaneously removed and passed through a filtering process which is interconnected with the rolling mill, after which the oil is resprayed onto the sheets. The rolling mill and oil filtration process are exempt.

During the hearing, Taxpayer was asked to provide pictures to demonstrate the location and use of the "mold platforms." However, Taxpayer did not provide the pictures. Therefore, Taxpayer has not provided sufficient information to demonstrate that the "mold platforms" are directly used in Taxpayer's production of its goods or that

they have "an immediate effect on the article being produced." Accordingly, Taxpayer's protest to the imposition of use tax on "mold platforms" is respectfully denied.

#### FINDING

Taxpayer's protest to the imposition of use tax on "manufacturing equipment" is sustained in part and denied in part. Taxpayer's protest to the imposition of use tax on "mold maintenance equipment" is denied, as discussed in subpart A(1). Taxpayer's protest to the imposition of use tax on "waterborne mold release system" equipment is denied, as discussed in subpart A(2). Taxpayer's protest to the imposition of use tax on the "glue gun holsters" is sustained, as discussed in subpart B. Taxpayer's protest to the imposition of use tax on "hydraulic oil" is denied, as discussed in subpart C. Taxpayer's protest to the imposition of use tax on "air monitoring equipment" is denied, as discussed in subpart D. Taxpayer's protest to the imposition of use tax on "seat pad cart carriers" is denied, as discussed in subpart E. Taxpayer's protest to the imposition of use tax on "platform molds" is denied, as discussed in subpart F.

### II. Sales and Use Tax—Property Used Outside of Indiana.

#### DISCUSSION

Upon reviewing the Taxpayer's fixed assets schedules, the Department determined that Taxpayer had purchased various "trial run materials" and/or "prototype materials." At the time of the audit, the auditor was unable to verify that Taxpayer paid sales tax at the time of the sales transaction and assessed use tax on these purchases.

As noted previously, The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

IC § 6-2.5-3-2(a) provides, "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." "Use" is defined at IC § 6-2.5-3-1(a) as "the exercise of any right or power of ownership over tangible personal property." "Storage" is defined at IC § 6-2.5-3-1(b) as "the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana."

Taxpayer asserts that its purchases of various "trial run materials" and/or "prototype materials" are not subject to Indiana use tax because these materials were not used in Indiana and were both delivered to and used in Japan, Tennessee, or Michigan. Taxpayer maintains that all research and development activities take place in Japan, Tennessee, or Michigan.

During the course of the protest Taxpayer provided some invoices and purchase requisition documents to demonstrate that the items were delivered to and used in Japan, Tennessee, or Michigan. It appears that several of the documents provided by Taxpayer have requisition addresses and/or delivered to addresses in Japan, Tennessee, or Michigan.

Accordingly, Taxpayer's protest is sustained, to the extent that Taxpayer has provided documentation demonstrating that the items were delivered and used outside of Indiana. However, Taxpayer's protest is denied, to the extent that it was unable to provide documentation demonstrating that the items were delivered and used outside of Indiana. The audit division is requested to review the submitted documents and to make whatever adjustments it deems appropriate.

#### FINDING

Taxpayer's protest to the imposition of use tax on "items delivered to and used outside of Indiana" is denied in part and sustained in part subject to the results of a supplemental audit.

### III. Sales and Use Tax—"Service and Installation Charges."

#### DISCUSSION

The Department imposed use tax on several transactions on which Taxpayer did not pay sales tax at the time of the retail transactions. Taxpayer asserts that the Department has assessed use tax on a number of sales transactions which represented "labor" and "installation" charges. Taxpayer asserts that these charges are not subject to sales and use tax under [45 IAC 2.2-4-2](#).

As noted previously, the Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

However, as explained in [45 IAC 2.2-4-2](#), what the regulation grants is "service providers" a narrow exception to collecting sales tax on the entire retail transaction—i.e., contract price if certain conditions are met. [45 IAC 2.2-4-2\(a\)](#) illustrates the exception, as follows:

(a) Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Accordingly, a person who obtains and sells tangible personal property that has been combined or altered with services is a "retail merchant" that must collect sales tax on its transactions unless the person meets all four of the requirements of a "service provider" as found in [45 IAC 2.2-4-2\(a\)\(1\)-\(4\)](#). A "service provider" meeting all of the four requirements, does not have to collect sales tax on its sales transactions, and instead is allowed to pay use tax on the "materials consumed [by the service provider] as a necessary incident to the service" provided to the customer.

During the hearing, Taxpayer provided a number of purchase orders, invoices, and purchase requisition forms. However, these documents failed to demonstrate that the transactions in question met all four requirements of a transaction of a "service provider" as found in [45 IAC 2.2-4-2\(a\)\(1\)-\(4\)](#). In fact, the documents demonstrated transactions where tangible personal property was the subject of the transactions and/or the materials provided were consequential exceeding ten percent of the total price. Nonetheless, Taxpayer points to line item charges on invoices or references made on the purchase documents that refer to assembly, fabrication, and installation, and claims that these amounts are not subject to use tax.

Usually, a service does not involve the transfer of tangible personal property and falls outside the scope of the sales and use tax. However, in "mixed transactions"—i.e., those transactions where tangible personal property is sold in order to complete a service contract, or where services are preformed in order to complete the sale of tangible personal property—it is often difficult to distinguish between the taxable sale of property and the non-taxable sale of services. *Allied Collection Service v. Ind. Dep't of State Revenue*, 899 N.E.2d 69 (Ind. Tax Ct. 2008), most recently summarized the parameters of analysis of "mixed transactions" as follows:

[T]he legislature has set forth several parameters for imposing tax on these transactions. First, taxable property does not escape taxation merely because it is transferred in conjunction with the provision of non-taxable services. A.I.C. § 6-2.5-4-1(c)(2). Second, services, generally outside the scope of taxation, are subject to tax to the extent the income represents "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." A.I.C. § 6-2.5-4-1(e)(2). Finally, services are also subject to tax if they are provided in the course of a retail unitary transaction, "a unitary transaction that is also a retail transaction." Ind. Code Ann. § 6-2.5-1-2(b) (West 2003). A unitary transaction is a transaction that "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." Ind. Code Ann. § 6-2.5-1-1(a) (West 2003) (Emphasis added).  
Id. at 72.

Therefore, there are two instances when an otherwise non-taxable sale of a service is subject to sales and use tax. The first is when the services are performed with respect to tangible personal property being transferred in a retail transaction and the services take place prior to the transfer of the tangible personal property. See IC § 6-2.5-4-1(e)(2) (providing that "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records" are included in gross retail income).

The second is when the services are part of a retail unitary transaction. IC § 6-2.5-1-2. A unitary transaction is defined as a transaction that includes the transfer of tangible personal property and the provision of services for a single charge pursuant to a single agreement or order. IC § 6-2.5-1-1. A retail unitary transaction is a unitary transaction that is also a retail transaction.

[45 IAC 2.2-1-1\(a\)](#) further explains:

For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

Thus, when a retail merchant includes both the charge for services and the charge for tangible personal property in one price in respect to a retail transaction, the charge is a unitary transaction and the retail merchant is responsible for collecting sales tax on the entire combined price it bills its customer.

Based upon the documentation presented, the transactions in question fall into these two categories and are subject to use tax. The line items in Taxpayer's invoices that referenced fabrication and assembly would be included in gross retail income because the items are charges for completion of the tangible personal property that take place prior to transfer of the property as provided in IC § 6-2.5-4-1(e)(2). As provided in the statute, the fact that these charges are stated separately does not change the fact that they represent an amount that is included as part of the retail transaction. Additionally, the line items from the invoices which include a single charge "for installation and fabrication" of an item of property would be subject to use tax as a unitary transaction as provided in IC § 6-2.5-1-2. Lastly, as to the transaction for the "scrap conveyor" where the invoice(s) had the following line items for "installation of a scrap conveyor," "supervision of installation," and "materials/consumable

cost for installation," it is not clear what these charges represent. The invoice did not have a separate line item for the purchase of the "scrap conveyor." In addition, Taxpayer has not presented evidence which would indicate that the "scrap conveyor" was purchased in another transaction. Without evidence of the separate purchase of the "scrap conveyor," the transaction in question represents charges for both the fabrication and assembly of the "scrap conveyor" and the labor for installation services. Thus, the "scrap conveyor" transaction represents a transaction that is taxable under IC § 6-2.5-4-1(e)(2) and IC § 6-2.5-1-2. Accordingly, Taxpayer has failed to meet its burden of proof to demonstrate that the assessments of use tax were incorrect as found in IC § 6-8.1-5-1.

**FINDING**

Taxpayer protest to the imposition of use tax on "installation and labor charges" is respectfully denied.

**SUMMARY**

Taxpayer's protest to the imposition of use tax on the "glue gun holsters" is sustained, as discussed in Issue I(B). Taxpayer's protest to the imposition of use tax on "items delivered to and used outside of Indiana" is denied in part and sustained in part subject to the results of a supplemental audit, as discussed in Issue II. In all other respects, Taxpayer's protest is denied.

*Posted: 05/30/2012 by Legislative Services Agency*

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